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The Commission has asked my views on resolving the structural fiscal issues which have recently confronted the State of California. By way of introduction let me state the obvious, that harnessing a democracy to the yoke of financial responsibility is one of the most intractable problems which any democratic society faces, not only in the State, but nationally and indeed globally. The global debt crises of the past few decades have largely been the result of quite analogous political breakdowns. Without an intimate knowledge of the California State system, any comments I can make would of necessity be very general.

The essence of Democracy is the compromise of competing priorities. When, as in California, opposing political forces are structurally frozen in a system of perpetual mortal combat from entrenched and virtually unassailable positions, compromise is usually a casualty. Couple it with the capacity of an aroused electorate at any time to change the terms of the discussion by simply enshrining a single position outside the compromise process through the initiative and it is no wonder that the financial community views California with somewhere between wonder and disbelief.

How the financial markets look at financial responsibility:

- Demonstrate recognition of the problem: For California, the symptoms are seen in the PRICE that California pays for its debt, not availability of funds. Debt should be viewed as either solution to a temporary or cyclical cash shortage or a capital investment issue. For example, investment in infrastructure, roads, water supply, etc. creates capacity to produce growth and therefore revenue. Conversely, there will never be enough money to satisfy every "good" idea. If one waits until funds dry up, it is too late. The market is reaching its limits. California has not yet shown that it understands this.

- Markets for debt are leery of uncertainty: California's decision process is broken and it is unclear how it can be fixed. Whether term limits, districting, or the existence of the initiative process is the key culprit is unclear but it is reasonably certain that each has contributed to produce an inability to impose discipline on the process. The fact of the recall is a positive sign and could provide a watershed if exploited vigorously. The balanced budget referendum and the creation of a reserve is a very important first step. Passage is critical but so is the political debate leading up to it. The Legislature itself could show some leadership with additional budget tightening procedures. Some legislatures impose on themselves a rule that they will not mandate any program without funding it which inhibits cost growth for political subdivisions as well. It would be helpful if both parties could support the Governor's proposal.

- Business and work create tax revenues: California has the widespread reputation of being very unfriendly to business; the litigation explosion in the area of employee rights, product liability, and other similar torts not only add significant costs to doing business but significantly inhibit creativity and investment in new ideas. The impact of various taxes is obviously key. There has been much discussion of the Workman's Comp issue. Often, the real problem is in the evaluation process and in the rules governing it. California's political leadership needs to recognize that other states (and increasingly foreign countries) not only provide much more investment friendly environments but are actively seeking investment through tax holidays and other measures. Short term measures might include an cabinet level function such as an Office of Business Investment which could act as an internal lobbyist/educator or behalf of California business, working with the various Chambers of Commerce.

- The budget process: Both parties need to demonstrate responsibility in the process. There are good ideas which can be: a) achieved later; b) through partnerships with the private sector; c) by the private sector alone with the right incentives and under realistic rules, d) not at all without unrealistic increases in tax rates. More money for education, for example, does not necessarily mean better education. As in the private sector, the State needs to look hard at what used to be called, "re-engineering" of the delivery process as well as what services, at what level, and to whom, the State can afford. Budgeting is inherently uncertain, even when approached in good faith.

- Are we taxing the right stuff? California also has the reputation of leading the nation, for good or bad. In the era of the knowledge and services economy, with tourism a very large part of our revenue, are we taxing accordingly.